Beyond the financial crisis - prospects and opportunities

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Good afternoon and thank you for the warm welcome.

Let me also thank the Trans Tasman Business Circle for giving me the opportunity to talk to you today.

For those of you who don't know my background, I hold both British and Irish passports, came here by way of Hong Kong and I now run an Australian and New Zealand bank.

Given the Bledisloe Cup is just over a week away and it is to be played at ANZ Stadium in Sydney, it's lucky I don't have to pick sides.

While I'm a great rugby fan – and some have suggested that may be why we sponsored the Bledisloe Cup in Hong Kong last year - in sport, like in business, I'm a great believer in taking emotion out of decision-making and simply looking at the data.

On that basis things don't look too good for the Wallabies.

The longest time the cup has been held by Australia is 5 years.

The longest time the cup has been held by New Zealand is 27 years.

As Damon Runyon once said: "The race may not always be to the swift, nor the victory to the strong, but that is sure the best way to bet".

There's no doubt that this rivalry between Australia and New Zealand in sport produces two countries that can punch above their weight in just about every area of international sport.

This makes sense in sport but I'm not sure it makes as much sense when it comes to some important areas of business where scale is critical.

I can't help thinking that here are two island nations, with small populations, in the middle of a huge ocean, a long way away from their original colonisers, whose national interests are both better served by working together to enhance the each other's individual strengths.

Sometimes, good natured rivalry lets us lose sight of this.

What I want to do this afternoon is share my views on the current state of the global economy and focus a little on the opportunities in New Zealand and Australia.

While we mightn't like it, it's at least reassuring to know that what is going on at present is part of a normal cycle.

As we have seen with every other economic cycle, these cycles are the result of technical, financial or managerial innovation.

The height of the cycle becomes a bubble, the bubble bursts, the electorate searches for a scapegoat and politicians react with greater regulation.

Of course more regulation won't necessarily stop the next bubble because, by definition, it will be based on a new innovation.

But things were difficult for business before the current crisis. It's hard to remember back all that time ago. You know back in years like 2006 when the world economy was going through a once in a generation boom.

It's worth reflecting that even then, Australian and New Zealand public companies, like other listed companies around the world, were facing what the Austrian economist Joseph Schumpeter called creative destruction.

In Australia for example, every decade an average of 12 companies disappeared from the list of the 20 largest companies.

If this was the average in the good times, what are things going to look like in this decade?

One thing that strikes me in the Southern Hemisphere is how limited the understanding is of the extent of the global recession.

Last week Lloyds Bank announced a loss for a half year of almost $10 billion with impairment charges of $33 billion. What's more amazing than the size of the loss is that the market reacted well to the news because it was within expectations.

And of course, it's worth reflecting that Lloyds and HBOS were at one time major players in retail and business banking in Australia and New Zealand.

A day or so later The Royal Bank of Scotland announced a $2.6 billion half year loss with impairment charges of over $18 billion.

I don't have to point out to you that both banks are now largely owned by the British Government.

Here, I know the economic reality is also tough.

- In 2008, the New Zealand economy grew by just under a quarter of a percent. This year, we expect the economy to contract by a bit over two percent.

- The unemployment rate has now reached 6% and is forecast to rise to 7.5% by the latter part of next year.

- For government, the impact is obvious with official forecasts showing a decade of fiscal deficits. This comes after years of record surpluses.

- And finally, in banking, impaired assets reported by the major New Zealand banks totalled nearly $2 billion as at the end of March 2009, significantly higher than the $350 million reported a year before.

It’s a sobering outlook, to say the least.

However, we need to remember that Australian and New Zealand banks are in good shape relative to their international peers – retail and business lending has been maintained and there’s been no need for government bailouts.

Let me reinforce this by reminding you that there are now only eleven AA-rated banks in the world. Four of those are the major Australian and New Zealand banks.

Those same four banks now rank in the 40 largest banks in the world by market capitalisation including ANZ at number 31.

The strength of our four major banks is in stark contrast to the plight of the northern hemisphere banks. There the weaknesses in the financial system have significantly amplified the effects of the downturn.

Since July 2007 in the US, the UK and Europe, there have been close to US$1.5 trillion in losses, at least 70 bank failures and over half a million jobs lost in financial services.

The IMF recently suggested that write-offs by financial institutions globally could reach US$4 trillion. To give you some perspective on that, US$4 trillion is around thirty times New Zealand’s GDP.

Personally, I’m not as pessimistic as the IMF and we’re beginning to see some early positive signs that the global financial system is beginning to stabilise.

Nevertheless, global economic activity is expected to fall by 1.1% this year, its first fall in 60 years.

And despite the recent rally in global equity markets, the reality is that I see little evidence of those ‘green shoots’ of recovery in the US and Europe. In fact, to be frank, they look pretty barren, particularly in Europe.

Just two weeks ago there were 14 and a half million people unemployed in the US. Last week the stock market took heart because of reports that only a quarter of a million Americans a month were now losing their job.

In our region – Asia Pacific - I’m more optimistic and there’s emerging evidence that we might just have be among the first countries to come out of the downturn.

So how do we respond as business people?

I was reminded recently that many companies react to a recession much as bears do in winter – by hibernating.

And we are seeing that in Australia and New Zealand.

Many have been reactive and have simply shrunk production capacity, reduced employee numbers and cut spending rather than anticipate the problems and prepare themselves for when the economy picks up again.

My view is that in business, no matter what stage of the cycle you're in, you have to have a clear objective based on real data and a clear plan to get you there.

Eighteen months ago we said our objective was to become a leading super regional bank in Asia Pacific.

This objective does not mean paying less attention to our home markets of Australia and New Zealand. In fact you can't be a strong player regionally without first being strong at home.

Based on data it's clear to us that in the 21st Century, Asia will increasingly be the engine room for the world economy.

It's our aim to help build Australia's and New Zealand's influence in Asia. It's equally clear that in the long-term domestic-only strategies are zero-sum games.

While the global economy is stabilising, the developed economies have a long way to go before we see real growth again. And that growth will be much slower than we saw before.

In contrast, there are almost four billion people in Asia.

Many of their economies are leaping from rural and low technology to urban, industrialised and high technology in a single step.

From ANZ's point of view this means a rapidly growing demand for financial services.

I know that business people in New Zealand also understand this opportunity and many of you here today are already working in Asia.

Let me offer you one fact to bring this opportunity alive.

By 2015, China will have more than four million wealthy households, making it the world's fourth-largest country in terms of the number of wealthy households after the United States, Japan, and the United Kingdom.

So, given that outlook, the real question for any major company anywhere in the western world isn't whether you should be in Asia but whether you can afford **not** to be in Asia.

I believe directors and management have a responsibility to their customers to support them in Asia. Equally I believe they have responsibility to their staff and their shareholders to give them exposure to Asia's growth and the opportunities it presents.

For us, this becomes even more compelling if your key franchise is situated in the region already.

And it's equally compelling when you realise just how interconnected Australia and New Zealand are with the rest of Asia.

In the past five years trade flows between Australia, New Zealand and Asia doubled to almost $300 billion and that will continue to accelerate.

And what makes the case for growing Asian presence is the simple fact that trade between the countries of Asia is now running at over $4 trillion.

And it's not only trade.

Australasian companies are realising that Asia has money to lend and to invest. ANZ has already led Asia-targeted transactions for companies like Wesfarmers, Woolworths and Fosters.

Of the top ten buyers of New Zealand merchandise exports, seven are Asian countries. Around sixty percent of those exports are to Australia and Asia.

Now you can understand why last week we agreed to buy a range of wealth management, retail, commercial and institutional businesses in six Asian countries from the Royal Bank of Scotland.

It is clear that the New Zealand Government understands China's importance – you were the first developed country to embark on free trade talks, and the first OECD country to sign a Free Trade Agreement with China.

This approach to engagement is clearly in the national interest and is the right approach now and for the future.

At the same time Asian governments, companies and individuals increasingly see Australia and New Zealand as safe and attractive places to invest.

As a result Asia, Australia and New Zealand have effectively become joined at the hip.

However, despite the opportunities that are now available to us, the new reality is that things will never go back to the way they were in banking over the last 5 to 10 years.

For example, the era in which money became the cheapest commodity in the world is over.

Today, in the US financial system, the philosophy has become akin to the creed I saw on restaurant walls when I was young: 'In God we trust; all others pay cash.'

Here in New Zealand, the cost of borrowing, even for AA-rated banks like ANZ National, remains high.

While it makes for good politics and good newspaper copy to link bank funding costs to the Reserve Bank's Official Cash Rate, the reality is very different.

The fact is bank funding costs have decoupled from the OCR. You only have to look at what banks are offering for deposits to see this.

The Official Cash Rate sits at 2.5%.

Yet, savers can get around 3% for call accounts, and short term deposit rates are up to 4.5% - significantly higher than the prevailing wholesale interest rate.

And this is only the cost of securing domestic funding.

New Zealand banks need to source around 40% of their funding needs from offshore, and this is still much more expensive than 18 months ago.

And of course this coincides with the philosophy of 'small government' being officially at an end – at least for the foreseeable future - with governments around the world now playing a much larger and much more directive role in the economy.

Economic stimulus packages put in place by governments in the last year now total more than US$2.5 trillion and we are seeing the early signs of re-regulation and various forms of subtle protectionism.

I also need to sound a note of caution here that while the inevitable aftermath of the recent failures in the financial system and in business may well be greater regulation – the essential task right now is to recover from the global recession we are in.

I want to acknowledge the depth of understanding there is of this in New Zealand.

As Prime Minister John Key said in a recent speech at Peking University "the biggest risk to New Zealand is that this global economic crisis unleashes a new wave of protectionist measures."

In these times, ultimately, real recovery depends on government demand being replaced by a sustainable recovery in private spending.

That requires a convincing restoration of business confidence.

And a sound banking sector is crucial to support this.

My view is that a resurgence of bank sledging, and the associated attacks on the Australian ownership of NZ banks might speak to our 'inner populist', but they simply don't help.

Let me briefly make some important points that I think have been drowned out in discussions on this issue to date.

- The major banks are profitable - although less profitable than before the crisis - and unlike many banks around the world they are strong, secure and AA rated.

- It's these solid foundations that have enabled the New Zealand banking industry to continue lending and supporting the New Zealand economy.

- And despite the fact that we've had to cut our cloth to suit the new environment, ANZ National remains one of New Zealand's largest companies with almost 8,500 staff, $140 billion in assets, and accounting for around 1% of New Zealand's GDP.

- And our commitment to New Zealand is unwavering – even though New Zealand produces lower returns than Australia, the recession is more pronounced in New Zealand and despite RBNZ capital rules are tougher than they are in Australia.

This reflects my own view that today, successful businesses need to play it long and try to avoid unnecessary tactical management or pandering to the short-termism of the market.

To deliver real value, particularly in this environment, actually requires a return to business basics like vision, consistency, discipline, experience and the skills to execute and to follow through.

That is why it is so critically important for business, to be able to capitalise on the opportunities that the interconnectedness between Australia, New Zealand and Asia brings.

We do need to deal with the challenges that have emerged after more than a decade of uninterrupted economic growth, but also set out the long-term architecture for the future.

This means recognising that our national interests are better served not only by working together to enhance each other's individual strengths but looking more broadly at Asia and the long term benefits of regional engagement.

Many thanks for listening to me this afternoon and I'm happy to take some questions.